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TAGS: [PGOV](#) [EPET](#) [ENRG](#) [ECON](#) [ETRD](#) [KCOR](#) [PREL](#) [PINS](#) [AG](#)
SUBJECT: OIL COMPANIES WORRIED ABOUT ALGERIA'S ENERGY FUTURE
REF: ALGIERS 0111

Classified By: Ambassador David D. Pearce. Reasons: 1.4 (b), (d)

Summary

¶1. (C/NF) Leading foreign oil companies (FOCs) are concerned that the corruption investigation into Algeria's national oil company Sonatrach (reftel) has paralyzed company decision-making and could slow ongoing projects. Unless Sonatrach consolidates under new management and resumes normal contracting, gas and oil production will suffer -- although no one will hazard a timeframe. Energy Minister Chekib Khelil is seen at the center of the rot in Sonatrach, and oil companies believe he remains the driver of Algeria's energy agenda and will not resign soon. However, the press reports that Prime Minister Ouyahia now signs off on major Sonatrach decisions. Some FOCs see this corruption investigation as a move against the influence of President Bouteflika's Western Algerian "clan." Embassy has no hard evidence to support this theory but notes that it enjoys widespread credence. Neither the corruption investigation nor any political conflict that may lie behind it will be resolved soon, in no small part due to President Bouteflika's slow and deliberate decision-making style. This scandal has further reduced the likelihood that Minister Khelil and Sonatrach will alert Algeria's leadership to the need for new investment to reverse the country's declining gas production, satisfy long-term export contracts, and meet rising domestic demand. End Summary.

Sonatrach Scandal Could Hurt Operations

¶2. (C/NF) Ambassador met with BP Country Manager Akli Brihi (protect throughout) and with ConocoPhillips Director General Armando Gallegos (protect throughout) separately on February 11. Brihi told the Ambassador that Sonatrach leadership has been "paralyzed and decapitated" by the Sonatrach corruption investigation because interim managers are afraid to sign contracts necessary for ongoing oil company operations. Gallegos said that their projects had not yet been affected since they were the operator of their largest project. He conceded there have been slowdowns in customs processing of imports and said that other companies' operations were already experiencing slowdowns.

¶3. (C/NF) Neither was sanguine about the prospects for the mid or longer term. Both feared that, given the current climate of uncertainty in Sonatrach, it would be some time before a strong replacement management team was in place. Brihi termed the acting CEO, Abdelhafit Feghouli, "hopeless" but thought he would stay on to continue organizing the April

LNG conference in Oran. Gallegos expressed concern about delays on the upstream side. He pointed out that there are many interim Sonatrach appointees in positions his company is not familiar with, positions they will retain for months or longer. Many decisions on upstream issues require signature by a Sonatrach VP, which these days are not forthcoming. However, Gallegos had good things to say about the interim Sonatrach VP for Upstream, Said Sahnoun, who retained responsibility for international business development, which was part of his previous position as Sonatrach head of partnerships. Gallegos saw Sahnoun as technically competent and a good English speaker; operations going through him would not be delayed.

Corruption Involves Service Companies, Not the Oil Majors

14. (C/NF) Brihi confirmed that the focus of the investigation into Sonatrach was the widespread use of no-bid, sole-source contracts. However, these were often necessary, and in any case were not forbidden by BP's contracts with Sonatrach. BP and Statoil, for example, had received "exemption" from this rule when they signed a sole-source contract with GE for gas turbines for their In Amenas gas project, since GE is the only company offering this kind of equipment. The company had carried out an internal investigation and cleared the deal. The across-the-board "dogmatic" prohibition against no-bid contracts now in place, Brihi maintained, would harm project development.

15. (C/NF) Brihi maintained that Sonatrach concluded corrupt deals not with the majors but with service companies such as the Italian firm Saipem. The service company would submit an inflated bid and then pay off Sonatrach insiders. It was the common belief that this had happened with the USD 1-billion sole-source contract Saipem had concluded with Sonatrach related to the Arzew LNG project. The Canadian company Lavalin's deal to build a new town ("La Nouvelle Ville") near the Sonatrach production center of Hassi Messaoud was tainted, and put on ice, he had heard, by a similar arrangement. The manager of that project, Mourad Zériati, was now in jail. Brihi thought that it was not inconceivable that U.S. companies had been involved in such deals, but he had never heard concrete information. The Ambassador reminded Brihi that U.S. companies were under the tough legal constraints of the Foreign Corrupt Practices Act.

Energy Minister Behind Culture of Corruption

16. (C/NF) Brihi believed that Minister of Energy and Mines Chakib Khelil was responsible for the culture of corruption in Sonatrach. He echoed reports Embassy has heard from other companies (reftel) that a Khelil relative (whom Brihi said was a nephew but whom others have said is a cousin) former Sonatrach Chief of Staff Reda Hemche, was the man behind the corrupt deals. Working on behalf of Khelil, Hemche would advise Sonatrach CEO Meziane on contracts to sign, making Meziane legally accountable and leaving Hemche out of legal reach. Brihi believed that Meziane had signed many such contracts under duress. Brihi said that Khelil had done an excellent job as minister until the passage of the 2006 hydrocarbon law, imposed against Khelil's will by "economic nationalists," which mandated Sonatrach majority participation and higher taxes on all Sonatrach contracts with FOCs. Stressing that he was providing his personal speculation, Brihi suggested that perhaps Khelil, faced with the defeat of his plans to change the system and liberalize the energy sector, may have decided that, if he could not change it, he would join it. He noted that it was after 2006 that Khelil installed Hemche and began replacing Sonatrach's most capable senior experts with "yes-men." He said the corruption investigation had drastically undermined Khelil's credibility, but predicted that the minister would not resign.

Political Backdrop

¶ 7. (C/NF) Brihi interpreted the anti-corruption investigation against Sonatrach by the DRS (Department des Renseignements et de Securite, the intelligence service formally under the military but in fact reporting directly to President Bouteflika) as a response to excessive influence by President Bouteflika's Western Algerian "clan." Brihi did not think this conflict would be resolved soon. He thought that Bouteflika would be inclined to keep Khelil, a childhood friend, in place. He would take his time to resolve the situation.

Algeria's Gas Future Imperiled

¶ 8. (C/NF) Brihi said the scandal had come at an especially bad time, because Sonatrach and the political leadership of Algeria had not awoken to the fact that Algeria faces declining gas production and the potential inability to satisfy export obligations and rising domestic demand as early as 2015. Sonatrach was not on track to realize Khelil's publicly stated goal of raising gas production from 60 to 80 billion cubic meters per year. Gas production was falling due to depletion of Algeria's easily accessible conventional gas reserves. Algeria needed to develop non-conventional gas. This included shale gas, reserves of which major oil companies believed were massive but whose exploitation required sophisticated know-how and large investments for development. Brihi said there were only three companies that had the technology and financial resources to do this: Exxon, BP and Shell. It would take time and up to USD 50 billion to develop the necessary infrastructure (including bringing large amounts of water to remote desert drill sites). Brihi believed that Algeria should also invest far more in solar energy and sell it to Sonelgaz. This would free up for export some of the large quantities of gas Sonatrach currently provided at low, subsidized prices to Sonelgaz for domestic electricity production.

¶ 9. (C/NF) Asked how high up knowledge of this future export-shortage dilemma extended, Brihi said Khelil understood but that he had not presented this "explosive dossier" to Prime Minister Ouyahia or President Bouteflika. Asked why the leadership had not focused previously on this, Brihi said Bouteflika was very intelligent but not a good listener and that energy in any case lay outside his main interest, which was politics. He left energy matters to Khelil, who remained the driver of Algeria's energy policy. While Sonatrach experts had known for years of this looming vulnerability, Khelil had moved many of them out or aside, and Khelil himself had not become fully aware of the issue until about a year ago. Brihi thought the corruption investigation would further delay the Algerian leadership's understanding of this looming crisis and complicate its ability to take the necessary decisions in time.

Comment

¶ 8. (C/NF) We still lack sufficient information to confirm the theory of clan warfare, but it enjoys greater credence here than the belief that the investigation into Sonatrach is a simple outgrowth of President Bouteflika's publicly stated determination to root out corruption. We anticipate that this affair will play out and continue to overshadow Algeria's energy industry for a considerable period, including the Sonatrach-organized LNG conference in Oran scheduled for 18-21 April. Energy Minister Khelil has been weakened, perhaps fatally. He faces a lose-lose situation, i.e., be blamed for either tolerating or being ignorant of corruption in the enterprise that is the crown jewel of his ministerial portfolio. One press report of February 17 said that Prime Minister Ouyahia now signs off on important Sonatrach contracts. However, we see no indication Khelil intends to resign or that President Bouteflika intends to replace him.

PEARCE